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In this installment of The Endres Assessment, the authors examine recent determinations on the taxation of information services and discuss the role of the "primary function" test in analyzing information services and other relevant types of transactions.

The data is in, and it's not great news for New York's wide-ranging efforts to impose tax on "information services." New York's Department of Taxation and Finance has recently lost a string of administrative appeals in this area — with a number of those losses having been handed down in just the past couple of months. While information-services disputes are certainly not a rarity (it's been one of the most litigated areas in New York sales tax), this recent line of determinations has centered on a particularly important issue in these cases — the "primary function" test — and should provide practitioners with some valuable guidance on the limitations of New York's ability to tax a service as an information service. In this article, we'll take a closer look at these recent determinations and the role of the primary function test in analyzing not just information services but other relevant types of transactions.

New York's Tax on Information Services

Before jumping into the decisions themselves, a little context is in order. Under New York tax law, only those services enumerated by statute are subject to sales and use tax. Among those, N.Y. Tax Law section 1105(c)(1) imposes tax on:

> The furnishing of information by printed, mimeographed or multigraphed manner or by duplicating written or printed matter in any other manner, including the services of collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof to other persons.

The regulations put it more succinctly, defining an information service as "the collecting, compiling or analyzing information of any kind or nature and the furnishing reports thereof to other

persons."[1] Tax Law section 1105(c)(1) has not been substantially amended since information services became subject to tax in 1965 (does anyone still use mimeograph machines?). Yet the language has been interpreted broadly enough over the past 50 years (whether by courts or the tax department's own guidance) to encompass everything from title searches and horse-racing tip sheets to online business networking sites and searchable databases. With the rise of the digital economy and the vast amount of information available online, it's hard to identify many services that don't incorporate "information" in some fashion. And, not surprisingly, New York has been increasingly aggressive in its attempts to bring a wide array of services into the information services fold.

One important check on this ability comes from the statute itself, which excludes the furnishing of information that "is personal and individual in nature and which is not or may not be substantially incorporated into reports furnished to other persons."[2] Given the broad language of the imposition statute itself, most of the case law on information services has centered on this "personal and individual" exclusion, which allows businesses that could otherwise be deemed "furnishing information" to nonetheless escape tax if the services are catered directly to a particular client and the information doesn't derive from a "common source or a data repository that is not confidential and is widely accessible."[3] However, meeting the exclusion can be tough since even the *chance* that such "common database" information could be substantially incorporated into reports furnished to different clients can be sufficient to defeat it.[4]

The bar was raised even higher in 2019, with the New York Court of Appeals' decision in *Wegmans*.[5] The court held in *Wegmans* (over a vigorous dissent) that a service providing "competitive price audits" to supermarkets failed the "personal and individual" test even though the audits were prepared based on items selected by the client and analyzed based on employees visiting competing supermarkets in person to observe the pricing practices on those items. To the dissenting justice, and to many New York practitioners, treating things that can be observed in a public setting, such as prices displayed on store shelves, as being derived from a nonconfidential and widely accessible source (that is, a common database) narrows the personal and individual exclusion beyond what the Legislature intended. The *Wegmans* court went a step further, however, and in a reversal of long-standing precedent from New York's Appellate Division, held that *exclusions* in sales tax imposition statutes must be construed the same as statutory *exemptions* — that is, narrowly, with any ambiguities resolved against the taxpayer and in favor of the tax department. That holding effectively upends the long-cited rule expressed by the Appellate Division that when "an exclusion from taxability is involved, it must be strictly construed in the taxpayer's favor."[6]

Suffice it to say that *Wegmans* has given the department the ammunition to even more aggressively pursue services it considers information services, and consequently it has magnified the importance of the primary function test when challenging assessments in this area.

The Primary Function Test

The primary function or "primary object" test is not unique to information services in New York — or even to the state of New York. Even states that don't tax services often employ a mode of analysis to determine whether the true object of the transaction is a nontaxable service or a taxable sale of tangible personal property. In New York, the "primary function" analysis stems from case law, perhaps best framed by the New York Tax Appeals Tribunal's decision in *Matter of SSOV '81 Ltd.*[7]

[1] N.Y. Comp. Codes R. & Regs. tit. 20, section 527.3(a).

[2] N.Y. Tax Law section 1105(c)(1).

[3] *See Matter of ADP Collision Estimating Services v. New York State Tax Appeals Tribunal*, 188 A.D.2d 245 (3d Dep't 1993) (citing *Matter of Towne-Oller and Associates Inc. v. New York State Tax Commission*, 120 A.D.2d 873 (3d Dep't 1986)).

[4] *See, e.g.*, *Matter of Rich Products Corp. v. Chu*, 132 A.D.2d 175 (3d Dep't 1987).

[5] *Wegmans Food Markets Inc. v. New York Tax Appeals Tribunal*, 33 N.Y.3d 587 (2019).

[6] *Matter of Towne-Oller and Associates Inc.*, 120 A.D.2d 873 (citing *Matter of Grace v. New York State Tax Commission*, 37 N.Y.2d 193 (1975)).

[7] *Matter of SSOV '81 Ltd.*, DTA Nos. 810966 and 810967 (N.Y. Tax App. Trib. Jan. 19, 1995).

In that case, the tribunal analyzed whether a matchmaking service through which members could access profiles and other information regarding potential singles was taxable. The tribunal made it clear that in construing whether a service qualifies as one of those enumerated in the tax law, the analysis "focuses on the service in its entirety, as opposed to reviewing the service by components or the means in which the service is effectuated." The tribunal emphasized that in the information services context, "the mere fact that information is transferred will not create a taxable event" or transform an otherwise nontaxable service into a taxable information service. It acknowledged that the shared member profile information may have provided a *means* through which the matchmaking service was accomplished, but viewed as a whole, the object of the service was to facilitate dating connections among members — a non-enumerated service. As the tribunal stated:

> We cannot accept the Division's argument that the means by which a service is provided is the controlling factor in determining whether the subject service is taxable. To neglect the primary function of petitioners' business in order to dissect the service it provides into what appear to be taxable events stretches the application of [the sales tax] far beyond that contemplated by the Legislature.

Even before *SSOV* formalized the "primary function" concept, New York courts had already made it clear that Tax Law section 1105(c)(1) could not be triggered anytime information was "furnished" in the course of providing a service. Rather, the service subject to tax under section 1105(c)(1) has been construed as "the sale of the service of furnishing information *by a business whose function it is to collect and disseminate information*."[8]

Despite this "primary function" limitation, the tax department has advanced aggressive arguments when dealing with vendors that incorporate information into their products. In fact, the tax department seems to have completely disregarded the holding in *SSOV*. In 2010 the tax department published a technical services bulletin memorandum that states, "A service is taxable as an information service if its primary function is one of the following: matching or networking services (examples include *online dating services*, physician matching services, and contractor locator services)."[9] Wait, what? Didn't *SSOV* conclude the exact opposite? The fact that one service uses the internet while the other is based on the exchange of hard copy profiles and videotapes should not change the taxability. It's this type of aggressive approach that led the tax department into some pretty indefensible positions.

The Tax Department's Terrible, Horrible, No Good, Very Bad Year on 'Primary Function'

With this context in mind, let's look briefly at the recent string of administrative decisions in this area, which provide valuable insight into the facts and arguments that help make an effective "primary function" case.

1. *Matter of Breakdown Services*, DTA 829396 (N.Y. Tax App. Trib. Jan. 27, 2022).

The taxpayer in this case provided an internet-based casting facilitation service designed to connect casting directors seeking actors for roles in films, television shows, commercials, and so forth, with talent agents representing actors. The online platform allowed casting directors to post details describing their productions and the roles they needed filled (called breakdowns), and it allowed talent representatives (for a subscription fee) to search and view those descriptions, submit suggested actor clients for the roles, and manage audition requests and communications from casting directors.

The tax department asserted that the service constituted an information service under Tax Law section 1105(c)(1) based on the assertion that the primary function of the service for subscribing talent representatives was the access to the information in the breakdowns, which were available to all who subscribed. But the tribunal did not have to look far to dismiss that argument.

[8] *Matter of Audell Petroleum v. New York State Commission*, 69 N.Y.2d 818 (1987) (emphasis added).

[9] New York State Department of Taxation and Finance, "Sales and Compensating Use Tax Treatment of Certain Information Services," TSB-M-10(7)S (July 19, 2010) (emphasis added).

It turned straight to *SSOV*, finding that the taxpayer's service of facilitating connections and communication between casting directors and talent representatives was analogous to the matchmaking services provided by SSOV. The tribunal highlighted the formal procedures that talent representatives had to follow in submitting their clients for posted roles and the ability (beyond merely viewing the posted breakdowns) to schedule auditions and communicate with casting directors. The tribunal distinguished the breakdown service from the apartment listing service found taxable in *Matter of Principal Connections*,[10] another often-cited information services case, noting that the service in *Principal Connections* merely offered access to a large listing of available apartments, whereas providing access to the casting breakdowns was merely one component of a larger service in the present case: "Unlike the apartment lists in *Principal Connections*, acting role descriptions have little value to talent representatives without the ability to submit actors for those acting roles."

2. *Matter of Lending Tree Inc.*, DTA No. 829714 (N.Y. Tax App. Trib. Dec. 9, 2021).

This administrative law judge determination is somewhat analogous to that in *Breakdown Services*, both in terms of facts and analysis. Here the petitioner operated an online marketplace designed to connect prospective borrowers seeking loans or other credit-based offerings with lenders looking for qualified borrowers. The service provided a platform over which borrowers could provide information on their financial status, type of loan sought, and so forth, and could be matched with a selection of prospective lenders. Based on the information provided by the borrower and a credit check run by the service, the service matched the borrower up with five lenders in the petitioner's network based on criteria they had provided, and it conveyed information to the borrower about the selected lenders (ratings, reviews, contact information, and so forth). Lenders paid the petitioner for the ability to participate in the marketplace —paying "match fees" for successful matches and "closed loan fees" for loans actually closed by the lender and a matched borrower.

As with *Breakdown Services*, the ALJ turned to *SSOV* as a guide to the primary function analysis, finding that the object of the service — what lenders paid for — was not merely background and credit information on potential borrowers. Rather, the service's primary function was "to facilitate the writing of loans by its customers," the participating lenders. According to the ALJ, "While the provision of information does take place; i.e., petitioner's transmission of a prospective borrower's financial information and loan requirements to a matched lender, petitioner's primary function is to consummate a loan." This was evidenced in part by the closed-loan fees that petitioner received, which were not paid unless the lender actually closed a loan with a matched borrower. The ALJ also pointed to the steps the petitioner took to help ensure that its matches resulted in closed loans, including criteria for allowing lenders to participate in the network and communicating with lenders during the closing process.

3. *Matter of Lender Consulting Services Inc.*, DTA No. 829198 (N.Y. Tax App. Trib. Dec. 2, 2021).

The petitioner in this case (which our firm litigated) was a real estate and environmental consulting firm whose services included preparing environmental risk assessments for banks and lenders. The "EA Quick" assessments at issue analyzed available information concerning the particular real estate parcel requested by the bank, as well as adjacent parcels within a specified radius, to assess the potential risk of environmental contamination on the site. The information reviewed included owner/operator questionnaires, historical maps, public records, and a database report that the petitioner purchased that listed any information on the parcel or surrounding parcels appearing in governmental and environmental databases. The resulting reports, which were required to be signed by a qualified environmental professional, contained a summary of the information reviewed and issues identified, along with a risk rating (low, elevated, or high) and recommendations for further action or review. All the underlying information relied upon for the report was included as an appendix to the report.

[10] *Matter of Principal Connections Ltd.*, DTA No. 818212 (N.Y. Tax App. Trib. Feb. 12, 2004).

The tax department argued that the primary function of the EA Quick reports was to provide lenders with publicly available information about the site (history, usage, and potential environmental concerns), and that they therefore constituted a taxable information service. The department acknowledged that the professional risk assessment was an aspect of the service but highlighted the sheer volume of information ultimately transferred to the client (for example, copies of the database reports, which often contained hundreds of pages of data, in contrast to the risk assessment, which typically numbered two to three pages). The ALJ disagreed, however, ruling that viewing the reports in their entirety, "their primary function is to provide financial institutions with a qualified environmental professional's review and opinion," not merely to collect and disseminate the underlying information relied upon. "The fact that petitioner includes the backup documentation used in making its opinion expressed in the report does not change the main purpose of the report," it said. Among the evidence found relevant by the ALJ was an affidavit from one of the petitioner's clients, a loan officer, who said the backup information would have little use to a bank without the services of petitioner's environmental professionals to interpret that information and assess risk.

One element of the ALJ's determination worth stressing is the initial discussion on the standard of review. As the ALJ emphasized, the threshold issue of whether a service falls within the ambit of Tax Law section 1105(c)(1) in the first instance involves the applicability of a tax *imposition statute*. Since section 1105(c)(1) itself is an imposition statute, any ambiguities over whether a service falls within the definition of an information service must be resolved against the tax department and in favor of the taxpayer.[11] As the ALJ noted, "in questions of statutory interpretation where the issue is the imposition of a tax, the statute cannot be read to allow the government to tax anything more than the clear terms of what the statute allows." Thus, in the wake of *Wegmans*, taxpayers face a somewhat lighter burden (at least in terms of statutory interpretation) in challenging an assessment on a *primary function* basis than in attempting to prove that the services constitute information services of a "personal and individual" nature. Indeed, the ALJ, for the sake of completeness, did analyze whether the EA Quick reports would meet the personal and individual exclusion if they were deemed an information service — holding (citing *Wegmans*) that the reports would fail the test by virtue of the public database information included.

4. *Matter of Marketshare Partners LLC*, DTA No. 828562 (N.Y. Tax App. Trib. Dec. 3, 2020).

This ALJ determination dates to December 2020, but is relevant for its robust primary function analysis, applied to a complicated set of facts involving a company that provided various marketing services to advertisers, media companies, and advertising agencies. In the determination, two out of three of the service offerings deemed by the tax department to be information services were found nontaxable under the primary function test, even though all three services involved the collection and analysis of large volumes of data.[12]

The ALJ found that neither the petitioner's "advertiser service" nor its "media company service" constituted an information service under Tax Law section 1105(c)(1). Both services involved gathering data from the client and from third-party sources to develop strategy recommendations and analytic modeling to increase marketing performance (for example, for advertisers, ways to best allocate advertising spending across various products, media, geographic areas, and so forth; and for media companies, ways to best represent the value of their platforms to advertisers). The results and models were provided to clients via both in-person presentations and access to an online platform from which clients could run models and create reports.

[11] *See Matter of Grace*, 37 N.Y.2d 193, *lv. denied*, 37 N.Y.2d 816 (1975).

[12] Note that N.Y. Tax Law section 1105(c)(1) excludes "the services of advertising" from taxable information services. Considering how much data is now used to target recipients for digital advertising, and considering how closely data companies are now involved in the delivery of digital ads, the distinction between taxable information and nontaxable advertising is unclear, to say the least.

The ALJ acknowledged that the "dissemination of information" was indeed a key aspect of both services. However, applying a primary function analysis, the ALJ determined that both services went beyond the mere collection and dissemination of information. The determination noted that "services recognized in case law as being information services have usually involved a service that provides quantitative information, and not guidance or advice." The ALJ also looked to the tax department's regulations on information services (whose examples include credit reports, tax or stock market analysis reports, product surveys, commodity price newsletters, and lists of prospective customers' telephone numbers) and found "very little sense that the 'information service' term was meant to cover a service of providing advice and guidance, developed with a specific customer in mind."

One service — the petitioner's "white paper service" — was deemed to constitute a taxable information service; however, the determination was based chiefly on a lack of information presented at hearing on the nature of the white papers in question. As described, the papers were prepared based on the same types of data gathered from clients, and they contained both advice and recommendations specific to the client as well as general information from industry sources. The ALJ explained that since no copies of the papers themselves were provided at hearing, "it is not possible to say . . . what the balance was between these two components of the white papers." And since the reports contained at least some publicly available, nonconfidential information, the inability to prove that the primary function was not the sale of "information" in the first instance would have raised a more difficult challenge under the personal and individual exclusion.

Conclusion

We've focused on information services cases in this article, but the tax department also came up short several times over the past year in attempts to tax several online services as pre-written software or software as a service, also losing on a primary function analysis.[13] This string of recent determinations helps build on the body of case law on the primary function test. Although ALJ determinations are not precedential in New York, they do provide practitioners with valuable insight on effective arguments to make and the types of evidence found relevant in these cases. Moreover, the string of losses for the tax department on information services cases will likely serve as an important check, particularly in light of the 2019 *Wegmans* decision, on the department's increasingly aggressive approach to taxing such services. ■

[13] *See Matter of 1Life Healthcare Inc.*, DTA No. 829434 (N.Y. Div. Tax App. Nov. 10, 2021) (holding that a "care navigation" service offering medical patients the means — including over an online or mobile platform — to navigate physician selection, booking of appointments, coordination of prescriptions, etc., was not a sale of software. Rather, the primary function was a non-enumerated service, and the access to the online and mobile platforms was merely the *means* by which the service was accessed); *see also Matter of It Works Marketing Inc.*, DTA No. 829134 (N.Y. Div. Tax App.Dec. 30, 2021) (holding that subscriptions to an online platform used by distributors of the petitioner's products to generate reports on their sales performance and commissions and similar tasks were not sales of access to pre-written software under a primary function analysis).